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H.R. 3355 - Homeowners' Defense Act of 2007

EXECUTIVE SUMMARY

Representative Ron Klein (D-FL) introduced the Homeowners' Defense Act of 2007 (H.R. 3355) on August 3, 2007. The bill, as amended, was approved by the Financial Services Committee on September 26, 2007, by a vote of 36 to 27. The bill is expected to be considered on the floor on November 8, 2007.

H.R. 3355 establishes the National Catastrophe Risk Consortium to allow states to voluntarily pool their catastrophe risk diversified by type of peril and geography. It also creates a Federal loan program to provide post-catastrophe financing for qualified State and regional reinsurance programs.

Republicans on the Financial Services Committee raised concerns that "the bill does not contain adequate mitigation provisions, could lead to increased building in vulnerable areas, and would unnecessarily burden taxpayers." The Administration issued a veto-threat of the bill, arguing "that private markets are the most efficient, lowest cost, and most innovative insurance providers. Therefore, the Administration strongly opposes H.R. 3355, which creates a permanent role for the Federal government in natural hazard insurance markets."

The Congressional Budget Office estimates that implementing this legislation would cost $75 million over the 2008-2012 period.

FLOOR SITUATION

H.R. 3355 is being considered on the floor pursuant to a structured rule. The rule:

- Provides one hour of general debate equally divided and controlled by the Chairman and Ranking Republican Member of the Financial Services Committee.

- Waives all points of order against consideration of the bill and the amendments except those arising under clause 9 (earmarks) and 10 (PAYGO) of Rule XXI.

- Provides that the amendment in the nature of a substitute recommended by the Committee on Financial Services now printed in the bill shall be considered as an original bill for the purpose of amendment and that it shall be considered as read.

- All points of order against the committee amendment in the nature of a substitute are waived except for clause 10 of rule XXI. This waiver does not affect the point of order available under clause 9 of rule XXI (regarding earmark disclosure).

- Makes in order only those amendments to the amendment in the nature of a substitute that are pre-printed in the *Congressional Record* or are pro forma amendments for the purpose of debate.

- Provides that each amendment printed in the *Congressional Record* may be offered only by the Member who caused it to be printed or a designee, and that each amendment shall be considered as read.

- Provides one motion to recommit with or without instructions.

- Provides that, notwithstanding the operation of the previous question, the Chair may postpone further consideration of the bill to a time designated by the Speaker.

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BACKGROUND

In recent years, states such as California, Florida, Louisiana, Mississippi, Oklahoma, and Texas have all experienced catastrophes. Specifically, hurricanes from 2004 and 2005 that struck the Gulf Coast have affected homeowner's insurance for residents of effected states. As real property values have increased, the threat of catastrophes continues, and as development has continued to expand, many private insurers have reduced their exposure and put a halt to new underwriting in states prone to such mega-catastrophes.

In the aftermath of Katrina, policymakers, disaster experts, and the insurance industry have all expressed varying concerns about the ability of the insurance industry to cover a future mega-catastrophe, and what role, if any, the federal government should play in financing catastrophic risks. While some insurance market analysts believe that all states in the union are subject to catastrophe exposure, many states feel that their taxpayer dollars should not subsidize a persons home who choose to live in a high-risk catastrophe area. In addition, some feel that it is an individual states responsibility to ensure that insurance companies within such state are charging actuarially sound prices that would cover loses should a catastrophe wreck havoc on any of the homes that they cover.

Several legislative proposals have been introduced since 1973 that have sought to correct federal disaster insurance. Since the 101st Congress, there have been over 60 legislative proposals dealing with federal disaster insurance. Many of these proposals dealt with how best to respond to the U.S. exposure to high-levels of risk from natural disasters; primarily hurricanes, floods, earthquakes, and windstorm risks.

SUMMARY

Title I – National Catastrophes Risk Consortium

Establishment; Status; Principal Office (Section 101)

- Establishes the "National Catastrophe Risk Consortium," known as the "Consortium."
- Establishes that any state may join on a voluntary basis if they have established a reinsurance fund or have authorized the operation of a State residual insurance market entity.

Functions (Section 102)

- Requires the Consortium to:
    - maintain an inventory of catastrophe risk obligations held by participating states;
    - issue securities and other financial instruments linked to catastrophe risk in the capital markets;
    - coordinate reinsurance contracts with private parties;
    - act as a database of State catastrophe risk information and make the database accessible to private parties;
    - perform research and analysis in order to standardize the risk-linked securities market;
    - perform any other functions necessary to aid in catastrophe risk transfer and;
    - submit an annual report to Congress highlighting and explaining its activities.

Powers (Section 103)

- Establishes that the Consortium may enter into public and private contracts and has necessary and incidental powers other than assuming risk or debt.

Non-profit entity; Conflicts of Interests; Audits (Section 104)

- Establishes that the Consortium is a non-profit entity;
- Prohibits conflicts of interest by prohibiting those officially affiliated with the Consortium from taking part in any decision-making affecting their private interests, partnership, or organization in which he or she is directly or indirectly interested.
- Requires that the Consortium's financial statements are audited annually by independent certified public accountants and included in an annual report to Congress.

Management (Section 105)

- Establishes that the Consortium is managed by a board of directors, composed of at least three members.
    - Requires the Secretary of Treasury to serve as the Chair.

- o Authorizes the Secretary of Homeland Security and the Secretary of Commerce to serve on the board, but only when there are fewer than two States participating in the Consortium.
  - o Authorizes a member from each State participating in the Consortium, and appointed by such State, to serve on the board.
- ➢ Authorizes the board to prescribe, amend, and repeal such bylaws as deemed necessary for carrying out the functions of the Consortium.
- ➢ Establishes that non-government members will be compensated and that federal government employees serving as members are not eligible to receive compensation.
- ➢ Establishes that members of the Consortium are entitled to receive travel expenses.
- ➢ Establishes that a majority of the board constitutes a quorum.
- ➢ Authorizes the board to appoint an executive director as they may determine.

<u>Staff; Experts and Consultants (Section 106)</u>

- ➢ Authorizes the board of the Consortium to –
  - o appoint and terminate staff as necessary to enable the Consortium to perform its duties;
  - o fix the compensation of the executive director and other staff; and
  - o procure the services of experts and consultants as considered appropriate.

<u>Federal Liability (Section 107)</u>

- ➢ Establishes that the federal government bears no liabilities arising from the actions of the Consortium.

<u>Authorization of Appropriations (Section 108)</u>

- ➢ Authorizes $20,000,000 to be appropriated for each fiscal year beginning in 2008 through 2013.

Title II – National Homeowners' Insurance Stabilization Program

<u>Establishment (Section 201)</u>

- ➢ Authorizes the Secretary of Treasury to make liquidity and catastrophic loans to qualified reinsurance programs (QRP) with the goal of ensuring the solvency of the programs, improving the availability and affordability of homeowners' insurance, incentivizing risk transfer to the private capital and reinsurance markets, and spreading the risk of catastrophic financial loss resulting from natural disasters and catastrophic events.

**Note: Qualified Reinsurance Program means a State or regional program that meets the requirements under section 301.*

<u>Liquidity Loans and Catastrophic Loans for State and Regional Reinsurance Programs (Section 202)</u>

- ➢ Authorizes the Secretary to enter into a contract with a QRP to carry out the purposed of this act.
- ➢ Establishes that a loan may only be made to a QRP if –

- Before the loan is made the State or regional reinsurance program submits to the Secretary a report on how the program plans to repay the loans; and based on that information the Secretary determines that the program can meet its repayment obligation under the loan and certifies that the program can meet such obligation;
- the program cannot access capital in the private market, including through cat bonds and other securities sold through the Consortium;
- the Secretary determines that an event has resulted in insured losses in a State with a QRP; and
- the loan is afforded the full faith and credit of the State and the State demonstrates to the Secretary that it has the ability to repay the loans.

- Requires a liquidity loan for a QRP to be subject to the following –
  - the Secretary must determine that the QRP has a capital shortage;
  - the program cannot access capital markets at effective rates of interest lower than those offered by this program;
  - the amount of the loan may not exceed the ceiling coverage level for the QRP;
  - the loan must bear interest at an annual rate 3 percentage points higher than marketable obligations of the Treasury; and
  - the loan must have a term to maturity between 5-10 years.

**Note: Ceiling coverage level means with respect to a QRP, the maximum liability under law that could be incurred at any time by the QRP.*

- Requires a catastrophic loan for a QPR to be subject to the following –
  - The Secretary must determine that an event has resulted in insured losses in a State with a QRP and that insured losses are in excess of 150 percent of the aggregate amount of direct written premium for privately issued property and casualty insurance, for risks located in that State, over the calendar year preceding such event;
  - The principal amount of the loan may not exceed the amount by which the insured losses sustained as a result of the event exceed the ceiling coverage level for the QRP;
  - The loan bears interest at an annual rate 0.20 percentage points higher than marketable obligations of the Treasury having a term to maturity of not less than 10 years and issued during the most recently completed month, as determined by the Secretary, or such higher rate as may be necessary to ensure that the amounts of interest paid under the loans exceed the sum of the costs of the loan, the administrative costs involved in carrying out a program under Title II for the loans, and any incidental effects on governmental receipts and outlays.
  - The loan must have a term to maturity of not less than 10 years.

**Note: Insured Loss means any loss insured by a QRP*

- Requires funds from loans to be used only to provide reinsurance or retrocessional coverage to underlying primary insurers or reinsurers for losses arising from all personal real property or homeowners' lines of insurance.

Reports and Audits (Section 203)

- Requires the Secretary to annually submit a report to the President and to Congress identifying and describing any loans made under Title II and any repayment received during such year.
- Requires the Secretary to provide for regular audits per each loan made under Title II, and to make the results available to the public.

Funding (Section 204)

- Authorizes the Secretary to establish and collect a reasonable fee from QRPs that are precertified to offset expenses in connection with carrying out the responsibilities of the Secretary; the expenses may include:
    - Costs of developing, implementing and carrying out the program under Title II; and
    - Costs for providing for precertification of State and regional reinsurance programs as QRPs.
- Authorizes the Secretary to adjust the fee, as may be deemed appropriate based on expenses of the Secretary relating to his or her responsibilities listed above.
- Establishes that any fees collected prior to this section to be credited as offsetting collections of the Department of the Treasury.
- Requires the Secretary to seek full repayment of all loans made under Title II. If the Secretary determines at any time that such full repayment will not be made, or is likely not to be made, the Secretary must submit a report to Congress explaining why full repayment will not be made or is likely to not be made.

Title III – General Provisions

Qualified Reinsurance Programs (Section 301)

- Defines QRPs as those that are –
    - Authorized by state law;
    - An entity in which authorizing state maintains a material financial interest;
    - Provides reinsurance or retrocessional coverage to underlying primary insurers or reinsurers for losses arising from all personal residential lines of insurance as defined in the Uniform Property & Casualty Product Coding Matrix published by the NAIC;
    - Has a governing body, a majority of whose members are public officials;
    - Provides reinsurance or retrocessional coverage to underlying primary insurers or reinsurers for losses in excess of the amount the Secretary has determined represents a catastrophic event in that particular State;
    - Complying with additional standards, such as –
        - Ensuring that any cost savings made under the QRP are reflected in premium rates charged to consumers for such coverage;

    - Requiring that any new construction, substantial rehabilitation, and renovation insured or reinsured by the program complies with applicable State or local government building, fire, and safety codes;
    - Requiring State authorized insurance entities to establish an insurance rate structure that takes into account measures to mitigate insurance losses;
    - Requiring State authorized insurance and reinsurance entities within the State to establish rates at a level that annually produces expected premiums that are sufficient to pay the expected annualized cost of all claims, loss adjustment expenses, and all administrative costs of reinsurance coverage offered; and
    - Encourages State authorized insurance and reinsurance entities within the States to establish rates that do not involve cross-subsidization between any separate P&C lines covered under the State authorized insurance or reinsurance entity;
  - Complying with additional organizational, underwriting, and financial requirements as the Secretary, by regulation, provided to carry out the purposes of this Act.
- Establishes that any state that does not have a QRP for the State, has 5 years, beginning on the date of the enactment of this Act, for a State residual insurance market entity to apply to the Secretary at any time for certification (and recertification) as QRPs.
- Requires the Secretary to establish procedures and standards governing the process by which State and regional reinsurance programs may apply for certification as QRP's.
- Establishes that nothing in this section is to be construed to limit or prevent any insurer from obtaining reinsurance coverage nor will it affect the calculation of the amount of any loan made under this Act.

COST

The Congressional Budget Office estimates that implementing this legislation would cost $75 million over the 2008-2012 period. (CBO Estimate – H.R. 3355, 10/30/2007)

ADDITIONAL VIEWS

The Administration issued a veto-threat of the bill, arguing "that private markets are the most efficient, lowest cost, and most innovative insurance providers. Therefore, the Administration strongly opposes H.R. 3355, which creates a permanent role for the Federal government in natural hazard insurance markets." (Statement of Administration Policy: HR 3355, 10/06/2007)

AMENDMENTS

(Below are summaries of the amendments that were pre-printed in the Congressional Record on November 6 and 7, 2007.)

1) Rep. Don Manzullo (R-IL): The bill establishes that a state is not eligible for any additional loans if it not current on all other federal loans related to this Act or other federal disaster loans.

2) Rep. Castor (D-FL): The amendment limits new development in zoning and planning programs in coastal areas that are prone to a high risk of catastrophic financial loss in accordance with standards established by the Secretary of the Treasury and in consultation with the Administrator of FEMA, and would limit rebuilding of substantially demolished structures after a catastrophic event.

3) Rep. Campbell (R-CA): This amendment would add commercial insurance coverage to the bill.

4) Rep. Matheson (D-UT): This amendment establishes that the first annual report submitted to Congress should also include an assessment of the costs to States and regions associated with catastrophe risk and an analysis of the costs and benefits, as well as for States not participating in the Consortium.

5) Rep. Shays (R-CT): The amendment would strike the text of bill and replace with a national catastrophe commission (H.R. 3644 – Shays/Blumenauer). The Commission would report specific recommendations to Congress to increase the availability and affordability of natural catastrophe insurance. It would also study the various nat cat insurance proposals currently before Congress.

6) Rep. Roskam (R-IL): The amendment would require the Treasury Department to certify that a state has implemented best practices building codes for the applicable exposures – taking into account the state's geography, catastrophe risk, and building patterns. This would not be a national building code, but rather a regionally specific criteria for program participation.

7) Rep. Price (R-GA): The amendment states that the Treasury Department will only issue subsidized federal loans after there is a determination that the reinsurance program will not displace the private market.

8) Rep. Price (R-GA): The amendment establishes that the Secretary will not issue any subsidized loans unless he or she determines that a natural disaster, or series of natural disasters, has occurred causing homeowners insurance losses to a) exceed the capacity of the insurance industry for that region; or b) exceed the amount equal to a 1 in 100 year event loss projected to incur from a natural disaster event or events.

9) Rep. Price (R-GA): The amendment establishes that no funds under the bill are made available if it results in a cost to the Federal Government, unless the Act provides for offsetting decreases in spending of the Federal Government.

10) Rep. Roskam (R-IL): The amendment establishes that before a qualified reinsurance program is eligible to receive a loan, that the program must pay equal to the cost of a 1 in 100 year event for the state.

11) Rep. Brown-Waite (R-FL): The amendment establishes that to qualify for the loans and federal catastrophe fund under the bill, states would have to establish anti-price gouging laws for post-event materials. Price gouging is defined as a supplier who is charging a price he/she knows is greater post-event than pre-event, not withstanding any reasonable business increases.

12) Rep. Roskam (R-IL): The amendment would require a state qualified reinsurance program to retain a loss of a 1:100 year event, before a state program could receive a catastrophic loan.

(13) Rep. Chris Murphy (D-CT): Amendment would require that an appropriate public body within the State adopt adequate mitigation measures (with effective enforcement provisions) that the Secretary finds are consistent with the criteria for construction described in the International Code Council building codes; and to the extent possible, seek to encourage appropriate state and local government units to develop comprehensive land use and zoning plans that include natural hazard mitigation; and that a program is considered to be a qualified reinsurance program if the Secretary certifies that for such year that the program is incompliance with all other requirements.

(14) Rep. Putnam (R-FL): The Amendment would require the Secretary of the Treasury to ensure that the State or regional reinsurance program enter into an agreement with the Secretary that the State will not use Federal funds of any kind or from any Federal source (including any disaster or other financial assistance, loan proceeds, and any other assistance or subsidy) to repay the loans; and that the Secretary cannot accept any repayment of any liquidity or catastrophic loan that does not comply with the agreement for such loan a state receives.

(15) Rep. Klein (D-FL): (Manager's Amendment) The amendment would remove requirement that qualified reinsurance programs be backed by the full faith and credit of their state; Clarifies that loans can only be made if the qualified reinsurance program cannot access capital in the private markets at a commercially reasonable rate; Establishes in the Treasury Department a Federal Natural Catastrophe Reinsurance Fund that would be authorized to write reinsurance contracts covering truly catastrophic-level events. Qualified reinsurance programs would be permitted to purchase one-year reinsurance contracts from the Fund to cover insured losses incurred by the qualified reinsurance programs. The Fund could provide reinsurance contracts for coverage that is available only after the qualified reinsurance program has sustained losses in an amount equal to losses projected from an event that has a 0.5 percent chance of being equaled or exceeded in any year (that is, a one-in-200 year event). Of the insured losses in excess of this amount, the reinsurance contract will pay 90 percent and authorizes aggregate liability for payment of claims under reinsurance contracts up to an amount of $200 billion, subject to such amounts as may be appropriated; Amends the eligibility provisions of the bill to add a risk-based capital requirement for qualified reinsurance programs. Qualified reinsurance programs must meet risk-based capital standards developed by the Secretary in consultation with the National Association of Insurance Commissioners (NAIC). The capital requirement will be based on an NAIC-developed formula that takes into consideration asset risk, credit risk, underwriting risk and other relevant risk determined by the Secretary; clarifies that certain state-sponsored insurance providers in California and Hawaii can serve as qualified reinsurance programs under the transitional terms; Requires Treasury to study the possibility of commercial residential line coverage; makes technical and conforming changes.

STAFF CONTACT

For questions or further information contact Brooke McKnight at (202) 226-2302.